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Clear Sailing Agreements: A Special Form of Collusion in Class Action Settlements

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Clear Sailing Agreements: A Special Form of Collusion in Class Action Settlements

William D. Henderson*

A clear sailing agreement (or clause) is a compromise in which a class action defendant agrees not to contest the class lawyer's petition for attorneys' fees. This Article argues that a clear sailing provision is often used to facilitate collusive settlements in cases involving nonpecuniary relief or common funds in which a defendant retains a reversionary interest. Because these types of settlements present difficult valuation problems, trial courts lack a clear benchmark for calculating attorneys' fees. Thus the defendants and the lawyer for the class can exploit this uncertainty by presenting an inflated settlement value to the court (to justify higher attorneys' fees) while simultaneously reducing the true cost to the defendant. Although courts purportedly apply "heightened scrutiny" to settlements involving clear sailing agreements, this approach rarely threatens the underlying settlement. As a result, clear sailing agreements tend to undermine the deterrence function of class action lawsuits by producing settlements that are systematically too low. This Article proposes a per se ban on settlements that rely upon clear sailing provisions. In addition, this Article recommends the appointment of a guardian ad litem to litigate the issue of attorneys' fees in all cases involving nonpecuniary relief or a claims-made reverter fund.

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I. INTRODUCTION

In recent years, class action settlements have increasingly relied on clear sailing agreements to resolve the issue of attorneys' fees. A clear sailing agreement (or clause) is a compromise in which the defendant agrees not to contest the amount awarded by the court presiding over the settlement as long as the award falls beneath a negotiated ceiling. One of the main criticisms of clear sailing provisions is that they represent prima facie evidence of simultaneous negotiations of merit relief and fees, which is a practice fraught with

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1. See Janet Cooper Alexander, Rethinking Damages in Securities Class Actions, 48 STAN. L. REV. 1487, 1534 (1996) (noting that most class action settlements "typically include[ ] a 'clear sailing' clause" to address attorneys' fees).

2. Weinberger v. Great N. Nekoosa Corp., 925 F.2d 518, 520 n.1 (1st Cir. 1991); *see also* Waters v. Int'l Precious Metals Corp., 190 F.3d 1291, 1292-93 (11th Cir. 1999) (reviewing a class action settlement where the plaintiff's counsel agreed that his fee petition would not exceed thirty-three and one third percent of the settlement fund and, per the terms of the clear sailing agreement, the defendant "will not directly or indirectly oppose Plaintiff's Class Counsel of Record's application for fees and expenses or compensation of the Representative Plaintiffs"); Alexander, *supra* note 1, at 1534 (stating that under a clear sailing clause, "the defendants agree not to oppose an attorneys' fee request of up to a specified amount").
serious ethical concerns for lawyers representing the class. Both courts and commentators have expressed apprehension that a plaintiff's counsel may be accepting a lower settlement for the class in exchange for a generous and nonadversarial treatment of fees. The prevailing response among the courts has been to subject such settlements to "heightened scrutiny," which occasionally results in an award of attorneys' fees that is lower than the ceiling amount specified in the clear sailing agreement.

This Article argues that the heightened-scrutiny approach serves as an ineffective deterrent to collusive settlements in which the plaintiff's counsel, under the guise of a clear sailing agreement, has settled for a smaller class award in exchange for preferential treatment on fees. Because judicial approval of these types of settlements takes place without the benefit of adversarial proceedings, the heightened-scrutiny approach exaggerates the ability of courts to detect impermissible trade-offs. Moreover, collusive parties can respond to

3. See, e.g., Malchman v. Davis, 761 F.2d 893, 908 (2d Cir. 1985) (Newman, J., concurring) (arguing that a clear sailing clause "creates the likelihood that plaintiffs' counsel, in obtaining the defendant's agreement not to challenge a fee request within a stated ceiling, will bargain away something of value to the plaintiff class" and suggesting that "perhaps they should be forbidden in all cases"); abrogated on other grounds by Amchem Prods. v. Windsor, 521 U.S. 591 (1997); Alexander, supra note 1, at 1535 (proposing that courts entertain fee requests only after a settlement has been approved by the court, thus eliminating the need for clear sailing clauses, as "such clauses have obvious potential to encourage collusive settlements"); Melvin R. Goldman & George Aguilar, Recent Developments in Attorney Fee Negotiation During the Settlement of Derivative and Class Action Suits, in PRACTISING LAW INSTITUTE, COURT AWARDS OF ATTORNEYS' FEES: LITIGATING ANTITRUST, CIVIL RIGHTS, PUBLIC INTEREST, AND SECURITIES CASES 199, 206 (1987) (noting that "the 'clear sailing' clause lends a air of collusion that may be harmful to the settlement of the merits").

4. See infra Part II.D.

5. See Malchman, 761 F.2d at 907-08 (Newman, J., concurring) (arguing that a clear sailing clause "deprives the trial court and a reviewing court of the certainty of having the propriety of the fee request tested in the adversary process" and noting that objectors cannot always be relied upon to fill this void). At present, there is no consistent rule that a notice for settlement containing a clear sailing agreement must include information on compensation that will be paid directly to class counsel; obviously, this information may be important to elicit effective objectors. Cf. In re Gen. Motors Corp. Pick-up Truck Fuel Tank Prods. Liab. Litig., 55 F.3d 768, 803 (3d Cir. 1995) (noting that failure of the notice to apprise class members of the substantial cash payment to the plaintiff's counsel when class relief was limited to coupons for the purchase of a new truck was strongly suggestive of a conflict of interest). Fortunately, the Supreme Court recently approved an amendment to Rule 23 that will require parties to "file a statement identifying any agreement made in connection with" any proposed settlement. U.S. Supreme Court Endorses Package of Federal Rule Amendments, 71 U.S.L.W. 2615, 2615 (Apr. 1, 2003) (quoting proposed Rule 23(e)(2)). Unless Congress alters the proposed rule, the amended version of Rule 23 will take effect on December 1, 2003. See id., available at http://www.uscourts.gov/rules/congress0303/CV-Letters.pdf (last visited Apr. 29, 2003).
the heightened-scrutiny approach by moderately inflating the ceiling amount for attorneys' fees in anticipation of a downward adjustment by the court.

This Article further argues that the heightened-scrutiny approach imposes a disincentive on only one collusive party, the plaintiff's attorney. Insofar as acquiescence on the issue of fees results in a lower settlement than would be possible if the plaintiff's counsel focused exclusively on relief for the class, defendants are likely to be the most consistent beneficiary of clear sailing agreements. The heightened-scrutiny approach is therefore problematic from a social perspective because it undercuts the deterrence function of the class action device and could lead to higher levels of wrongful or illegal conduct by defendants.

Finally, close examination of the case law reveals that clear sailing agreements are especially prevalent in settlements involving either nonpecuniary relief or a claims-made common fund where the defendant retains a reversionary interest. Because these cases represent extremely difficult valuation problems that do not exist in a typical common-fund case, courts should respond by adopting procedural safeguards that are specifically designed to protect the interests of the class. Notwithstanding the favorable view toward class action settlements that exists within the federal judiciary, this Article proposes that the most effective mechanism for minimizing collusive negotiations and preserving the deterrence function of class actions is for courts to adopt a per se rule that rejects all settlements that include clear sailing provisions. Such a rule would encourage plaintiff's

6. See Richard A. Posner, Economic Analysis of Law 626-27 (5th ed. 1998) (arguing that "the most important point [of a class action] from an economic standpoint is that the violator be confronted with the costs of his violation—this achieves the allocative purpose of the suit—not that he pays them to his victims"); see also infra Part III.B.
7. See infra Part II.B.
8. See, e.g., Linney v. Cellular Alaska P'ship, 151 F.3d 1234, 1238 (9th Cir. 1998) (stating that "very limited" review of a district court's decision to certify a class action settlement is supported by a "strong judicial policy that favors settlements, particularly where complex class action litigation is concerned") (quoting Class Plaintiffs v. Seattle, 955 F.2d 1268, 1276 (9th Cir. 1992)); In re Gen. Motors Corp., 55 F.3d at 784 (noting that "the law favors settlement, particularly in class actions and other complex cases where substantial judicial resources can be conserved by avoiding formal litigation"); In re U.S. Oil & Gas Litig., 967 F.2d 489, 493 (11th Cir. 1992) (noting that "[p]ublic policy strongly favors the pretrial settlement of class actions lawsuits"); Weinberger v. Kendrick, 698 F.2d 61, 73 (2d Cir. 1982) ("There are weighty justifications, such as the reduction of litigation and related expenses, for the general policy favoring the settlement of litigation. . . ."); Cotton v. Hinton, 559 F.2d 1326, 1331 (5th Cir. 1977) (acknowledging "an overriding public interest in favor of settlement" of class actions).
counsel to focus solely on the benefit to the class. After the defendant's total liability has been fixed through the settlement process, plaintiff's counsel can then petition the court for fees under the equitable common-fund doctrine. Because the common-fund doctrine places the plaintiff's counsel in a position that is directly adverse to the class, a court can use its supervisory authority under Rule 23 to appoint a guardian ad litem to represent the class on the issue of attorneys' fees. A plaintiff's counsel that has diligently represented the interests of the class in the settlement process should be able to marshal sufficient evidence to justify a relatively high fee award under either the percentage of the common fund or the lodestar with multiplier method of calculating attorneys' fees.

Part II of this Article surveys the case law that has addressed the issue of clear sailing agreements, including the emergence of the heightened-scrutiny approach. Part III argues that settlements that include a clear sailing agreement are likely to impose a less than optimal level of liability on defendants while, on average, rewarding class counsel for trading merit relief for higher fees. Finally, Part IV recommends that courts adopt a per se rule against settlements that include a clear sailing provision. It also details how this approach would be implemented in cases involving nonpecuniary relief or a

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10. District courts have occasionally used this mechanism in traditional common-fund cases. See, e.g., Meyer v. Citizens & S. Nat'l Bank, 117 F.R.D. 180, 183 n.3 (M.D. Ga. 1987) (noting that the guardian ad litem appointed by the court to represent the class will be paid out of the settlement fund at the conclusion of the case); Haas v. Pittsburgh Nat'l Bank, 77 F.R.D. 382, 383 (W.D. Pa. 1977) (asserting that a judge cannot adequately represent the class on the issue of fees while also maintaining "his acknowledged duty to act as an impartial arbitrator" and "[t]he appointment of a guardian for the class obviates this considerable problem of judicial schizophrenia"); Miller v. Mackey Int'l, Inc., 70 F.R.D. 533, 535 (S.D. Fla. 1976) (noting that "the interest of the class members is specifically adverse to the interest of their lawyers who seek an attorney's fee . . . from the settlement fund" and that "this procedure both achieves protection for the members of the class and enables the trial judge to remain in an impartial position" and stating that authority to appoint a guardian ad litem "is inherent within Rule 23(d)").

11. See City of Burlington v. Dague, 505 U.S. 557, 566 (1992) (observing that lodestar multipliers and percentage models are similar to contingency arrangements where the lawyer adjusts his fee to cover the risk of nonpayment).
reversionary interest, including the process for determining attorneys' fees.

II. JUDICIAL RESPONSE TO CLEAR SAILING AGREEMENTS

From a legal-doctrine perspective, clear sailing agreements are problematic because they are perceived as a form of simultaneous negotiations of attorneys' fees and merit relief. This Part examines the judicial response to simultaneous negotiations as it has evolved during the last twenty-five years. Subpart A discusses the emergence of the Prandini rule in the mid-1970s, which barred the approval of class action settlements that were a product of simultaneous negotiations. Subpart B examines the type of class action settlements that have most frequently included clear sailing agreements. Subpart C considers Malchman v. Davis, which was the first appellate case to squarely address the use of clear sailing agreements in class action settlements and resulted in a split-panel decision with three divergent approaches to clear sailing agreements. Finally, subpart D summarizes the subsequent development of the heightened-scrutiny approach, which often includes a downward adjustment in attorneys' fees but rarely threatens the settlement itself.

A. The Prandini Rule and the Ban on Simultaneous Negotiations

In 1977, the United States Court of Appeals for the Third Circuit became the first federal appellate court to address the propriety of simultaneous negotiations in the class action setting. In Prandini v. National Tea Co., attorneys sought approval of a class action settlement involving charges of sexual discrimination against a private

12. For a useful overview of these more complicated forms of class actions settlements, including a taxonomy of cases into five discrete categories of nontraditional damages relief, see Geoffrey P. Miller & Lori S. Singer, Nonpecuniary Class Action Settlements, 60 LAW & CONTEMP. PROBS. Summer 1997, at 97, 101-07.

13. See Prandini v. Nat'l Tea Co. 557 F.2d 1015, 1021 (3d Cir. 1977) (holding, in a case involving a clear sailing agreement, that the trial court must approve class relief before permitting parties to negotiate the issue of attorneys' fees).

14. 761 F.2d 893, 906 (2d Cir. 1985) (approving class action settlement despite presence of clear sailing agreement).

15. The Prandini rule was foreshadowed by an earlier district court decision, Jamison v. Butcher & Sherred, 68 F.R.D. 479, 484 (E.D. Pa. 1975), which rejected a proposed settlement as inadequate and "disapproved generally of settlements containing agreements on fees." See also Third Circuit Report, supra note 9, at 267 (discussing first cases dealing with simultaneous negotiations of merit relief and attorneys' fees in a class action context).
employer. The agreement included $97,000 in class relief, a $15,000 payment to the representative plaintiff, and a clear sailing provision in which the defendant agreed not to contest any request for attorneys’ fees at or below the $50,000 ceiling amount. The district court approved the relief for the class but had a separate hearing to address the issue of attorneys’ fees. The amount eventually awarded reflected a downward adjustment from the initial fee petition. On appeal, the Third Circuit vacated the lower court order and proposed the general rule that a trial court presiding over a class action should insist upon a settlement on damage relief before permitting parties to negotiate the issue of fees.

Although commentators viewed the Prandini rule as a laudable attempt to deal with a serious structural problem in class action settlements, strict adherence to the decision ultimately proved impractical. The primary criticism levied against Prandini was that it tended to discourage settlements by limiting the ability of a defendant to ascertain the full extent of its liability. However, in 1986, shortly


17. Prandini, 557 F.2d at 1018 (commenting that the defendant “had agreed to pay a sum up to $50,000 if approved by the court, [and therefore] it did not contest the fee award in the district court. In the interest of consistency, the [defendant] . . . has not participated in the appeal”). Although it may be obvious to the reader, it is hard to construe the $15,000 payment to the named plaintiff as anything but a thinly veiled bribe to abandon the interests of the class.

18. Id. at 1017-18.

19. Id. at 1018, 1020-21 (noting the district court’s skepticism of “a sweetheart contract”).

20. Id. at 1021 (holding that “[o]nly after court approval of the damage settlement should discussion and negotiation of appropriate compensation for the attorneys begin”).

21. See, e.g., Third Circuit Report, supra note 9, at 268 (discussing general approval among commentators); John C. Coffee, The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation, 48 Law & Con temporary Probs., Summer 1985, at 5, 71 & n.207 (citing Prandini as an example of a “prophylactic rule” that forbids adversaries from negotiating the fee award until after the settlement has been judicially approved and discussing how the rule reduces potential for collusion); Deborah L. Rhode, Class Conflicts in Class Actions, 24 Stan. L. Rev. 1183, 1207-09 & n.100 (1982) (noting how Prandin’s ban on simultaneous negotiations eliminates even the appearance that a plaintiff’s counsel “recoup[ed] his own investment at his clients’ expense”).

after a task force was convened in the Third Circuit to examine the issue of court-awarded attorneys’ fees, the United States Supreme Court ruled in *Evans v. Jeff D* that the language of the federal civil rights fee-shifting statute, 42 U.S.C. § 1988, did not preclude simultaneous negotiations when the parties determined that such a discussion would be conducive to settlement.23 According to the Court, an absolute ban would be highly counterproductive, “forcing more cases to trial, unnecessarily burdening the judicial system, and disserving civil rights litigants.”24 Therefore, at least in cases which potentially implicate § 1988, the *Prandini* rule has been expressly overruled.25

### B. Simultaneous Negotiations and the Common Fund

Despite the Supreme Court’s ruling in *Evans*, federal appellate courts have continued to struggle with the issue of simultaneous negotiations in traditional class action cases where an attorney’s right to payment is based upon a common benefit he has conferred upon the class. However, a careful review of the case law suggests that simultaneous negotiations in the form of a clear sailing agreement are least problematic in typical common-fund cases. This assertion is based on the fact that a defendant who has settled a class action lawsuit is ultimately indifferent to how a single lump-sum payment is apportioned between the plaintiff’s attorney and the class.26 In contrast, clear sailing agreements typically arise in settlements involving class relief that is either nonpecuniary,27 a claim-made fund

23. 475 U.S. 717, 737-38 (1986) (concluding that “it is not necessary to construe the Fees Act as embodying a general rule prohibiting settlements conditioned on the waiver of fees in order to be faithful to the purposes of that Act”).

24. *Id.* at 736-37.

25. *See id.* at 725-26 & nn.10-11 (reversing holdings of *Prandini* and an identical ruling in the United States Court of Appeals for the Ninth Circuit, *Mendoza v. United States*, 623 F.2d 1338 (9th Cir. 1980)).

26. *See, e.g., In re Gen. Motors Corp. Pick-up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 818-20 (3d Cir. 1995) (observing that “a defendant is interested only in disposing of the total claim asserted against it; . . . the allocation between the class payment and the attorneys’ fees is of little or no interest to the defense” (alteration in original) (quoting *Prandini v. Nat’l Tea Co.*, 557 F.2d 1015, 1020 (3d Cir. 1977)); *Janet Cooper Alexander, Do the Ments Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 547 (1991) (noting that the amount of attorneys’ fees in securities litigation typically “makes no difference to the defendants since the fee comes out of the common fund”).

27. *See, e.g., Johnston v. Comerica Mortgage Corp.*, 83 F.3d 241, 242-43 (8th Cir. 1996) (noting a clear sailing agreement used in settlement of a class action involving $.68 in monetary relief to each class member plus injunctive relief); *BTZ, Inc. v. Great N. Nekoosa Corp.*, 47 F.3d 463, 465 (1st Cir. 1995) (reviewing a clear sailing agreement used in a derivative class action where the alleged benefit to the shareholders was getting the
subject to a reverter clause, or a cash settlement where a separate cash payment for attorneys' fees is made directly from the defendant to the lawyers representing the class.

In the later category dealing with separate cash payments, clear sailing agreements appear to be a way for the plaintiff's attorney to contract around the customary methods of calculating attorneys' fees under the common-fund doctrine. However, cases involving nonpecuniary relief or a reverter fund often provide a benefit to the class that cannot be readily calculated. In addition, nonpecuniary relief often lacks a liquid component that can be used to pay attorneys' fees. Thus, a clear sailing agreement solves the liquidity problem and allows the plaintiff's attorney and the defendant to ascertain their respective benefits and liabilities before agreeing to terminate the lawsuit. Not surprisingly, courts that have directly confronted clear sailing agreements have speculated that such agreements may ultimately be struck at the expense of the class. The more difficult question is how to correct these incentives.

C. Malchman v. Davis: Raising the Red Flag on Clear Sailing Agreements

The origins of the heightened-scrutiny approach to clear sailing agreements can be readily traced to Malchman v. Davis, a 1985 decision from the United States Court of Appeals for the Second

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28. See, e.g., Waters v. Int'l Precious Metals Corp., 190 F.3d 1291, 1292 (11th Cir. 1999) (reviewing a clear sailing agreement used in a reversionary fund settlement of a commodities fraud class action); Duhaime v. John Hancock Mut. Life Ins., 989 F. Supp. 375, 376-79 (D. Mass. 1997) (noting clear sailing agreement used to specify $39 million in attorneys' fees when total relief to the class would depend on number of class members filing claims under an ADR process, thus making total valuation of settlement speculative); Levit v. Filmways, Inc., 620 F. Supp. 421, 422 (D. Del. 1985) (examining a clear sailing agreement used to specify $183,750 in attorneys' fees and the defendant retained reversionary interest in the common fund, making the benefit to the class speculative).

29. See, e.g., Malchman v. Davis, 761 F.2d 893, 905-06 & n.6 (2d Cir. 1985) (discussing a fee arrangement where the majority of the fee was paid directly by the defendant to the plaintiff's attorney). It should be noted that in Malchman it is plausible to argue that the class component of the award was of less significance than the change in business practices won by the settlement. Thus the clear sailing agreement was one way for the plaintiff's attorney to calculate the combined benefit of the cash and nonpecuniary components of the settlement.

30. See supra notes 9-10, 28-29 and accompanying text.
Circuit that resulted in three divergent opinions. In *Malchman*, a class action lawsuit was initiated against an insurance company that allegedly committed fraud and breach of fiduciary duty in the sale and administration of group health insurance policies. The vehicle for selling the disputed policies was an exclusive relationship between the defendant and the American Association of Retired Persons (AARP). In negotiating a settlement, the defendant agreed to terminate its contractual relationship with the AARP, relinquish its control of membership lists, and pay approximately $11 million to various chapters of the AARP. Pursuant to a clear sailing provision, the defendant also agreed not to contest a fee application of up to $2.35 million, of which the majority would be paid directly from the defendant to the plaintiff’s attorney. Remarkably, the settlement included no relief for the AARP members who had actually purchased the overpriced insurance policies.

Although the majority opinion expressed discomfort that fees and merit relief appeared to have been negotiated simultaneously, the court ultimately approved the settlement after modestly reducing attorneys’ fees to $1.9 million. However, in a vigorous dissent, Judge Mansfield argued that the settlement had been seriously tainted by simultaneous negotiations and pointed to numerous statements in the record that strongly suggested that the issue of fees had been an integral part of discussions at every phase of the negotiating process. Moreover, Judge Mansfield was incredulous that claims for individual damages, potentially worth a total of $250 million before trebling, could be

31. 761 F.2d 893 (2d Cir. 1985).
32. Id. at 896.
33. Id. (describing the evolution of the lawsuit).
34. Id. at 897 (describing terms of the settlement).
35. Id. at 905 n.6 (summarizing the mathematical formula whereby the defendant agreed to pay ninety percent of all expenses and fees up to $1 million dollars and seventy percent of the remainder up to $2.325 million, with the balance paid out of proceeds to the AARP).
36. Id. at 902-03 (acknowledging that “[o]n first impression, chronology alone suggests . . . little more than a trade of damages relief foreclosure for attorneys’ fees” because the other terms appeared to be part of an earlier voluntary agreement between the AARP and the defendant insurance company). It is noteworthy that more than 3000 class members had opted out prior to the Second Circuit’s approval of the settlement. See id. at 902.
37. Id. at 906 & n.8 (reducing AARP portion of attorneys’ fees from $425,700 to $252,683 while upholding the $1.6 million payment from the defendant directly to class counsel).
38. Id. at 910 & n.2, n.5 (Mansfield, J., dissenting) (providing lengthy excerpt of transcript recorded by state court referee where the attorneys for the defendant and the plaintiff class acknowledged discussion of fees at several points prior to a settlement of the merits).
extinguished for a relatively modest payment to the AARP and a very substantial payment to the lawyers representing the class. Finally, the dissent expressed serious doubt in the propriety of approving a class action settlement in which the representative plaintiffs were the brother and mother-in-law of the legal counsel for the class.

In a concurring opinion, Judge Newman objected to the continued use of clear sailing agreements in class action settlements. According to Judge Newman, there is an important distinction between a legitimate “ceiling” clause, which restricts the fee request of plaintiff’s counsel but permits a defendant to ascertain his maximum liability, and a “clear sailing” clause, which restricts the defendant’s ability to object to exorbitant fees. In the latter category, Judge Newman observed two potentially adverse effects. First, such an agreement “deprives the trial court and a reviewing court of the certainty of having the propriety of the fee request tested in the adversary process.” Second, it increases “the likelihood that plaintiffs’ counsel, in obtaining the defendant’s agreement not to challenge a fee request within a stated ceiling, will bargain away something of value to the plaintiff class.” Judge Newman went on to argue that clear sailing agreements should be carefully scrutinized or altogether forbidden in future cases. Yet, notwithstanding his strident tone, he declined to object to its use on the facts of this case.

D. The “Heightened-Scrutiny” Approach

In the aftermath of Malchman, courts have frequently relied on Judge Newman’s concurrence and its progeny to apply a heightened level of scrutiny to class action settlements and fee petitions that utilize clear sailing agreements. Although such an approach may have a

39. Id. at 909 (Mansfield, J., dissenting) (“This tantalizing prospect can tempt class counsel, consciously or not, to agree to settlement terms that are less favorable to their clients than would otherwise be the case.”).
40. Id. at 912 (Mansfield, J., dissenting) (commenting that surrounding circumstances of the case suggest that the named plaintiffs would likely to be more inclined to “give up their potential recoveries than would the other eleven million plus members of the class who have no such relationships with class counsel”).
41. Id. at 906-08 (Newman, J., concurring).
42. Id. at 907 (Newman, J., concurring).
43. Id. (Newman, J., concurring).
44. Id. at 908 (Newman, J., concurring).
45. Id. (Newman, J., concurring).
46. See id. (Newman, J., concurring) (upholding the settlement because parties had no prior reason to doubt the validity of the clear sailing agreement).
47. See, e.g., Weinberger v. Great N. Nekoosa Corp., 925 F.2d 518, 524-25 (1st Cir. 1991) (citing the Newman concurrence and concluding that “heightened judicial oversight of
strong theoretical appeal, its application typically results in either a reduction in attorneys’ fees or an approval of the fee request in total. Furthermore, a careful review of the case law found no reported cases in which the alleged heightened level of scrutiny resulted in the disapproval of the underlying settlement. As a result, defendants who enter into a clear sailing agreement can enjoy a high degree of confidence that their total liability for damage relief and attorneys’ fees has been successfully capped.

Yet the primary flaw in the heightened-scrutiny approach is perhaps most evident in Malchman itself. Although Judge Newman’s concurrence strongly criticized the potentially adverse effects of clear sailing clauses, his vote simultaneously approved a settlement that had clear record evidence of simultaneous negotiations occurring over a prolonged period of time, the termination of claims totaling more than

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48. See BTZ, Inc. v. Great N. Nekoosa Corp., 47 F.3d 463, 466-67 (1st Cir. 1995) (affirming the lower court decision to deny attorneys’ fees in a derivative class action because class counsel failed to carry the burden that his efforts were the catalyst to the benefit that accrued to the corporation); Duhaime v. John Hancock Mut. Life Ins., 989 F. Supp. 375, 380 (D. Mass. 1997) (provisionally upholding full attorneys’ fees and releasing approximately sixty percent immediately and the remainder on a staged basis according to the number of claims processed against defendant); In re Fleet/Norstar Secs. Litig., 935 F. Supp. 99, 104, 116-17 (D.R.I. 1996) (denying a $499,000 fee request in a derivative class action because the class counsel could show no credible causal link between his efforts and the benefit accruing to the corporation); Levit, 620 F. Supp. at 422, 427 (awarding $160,000 of a fee request of $183,750 after conducting lodestar and percentage of the fund analysis).

49. See Waters v. Int’l Precious Metals Corp., 190 F.3d 1291, 1298 (11th Cir. 1999) (upholding full attorneys’ fees per the clear sailing agreement despite disagreement between class counsel and defendant on its proper interpretation); Johnston v. Comerica Mortgage Corp., 83 F.3d 241, 247 (8th Cir. 1996) (reversing a lower court decision that denied attorneys’ fees due to failure to submit time records and reasoning that class counsel had relied on similar settlement agreements to justify fees in an earlier decision that was approved by the United States Court of Appeals for the Eighth Circuit).

50. More vigilant judicial supervision is the most common bromide for the numerous agency problems that plague class action litigation. As Professor Coffee has observed, “Although many reforms are possible and could succeed, only one is sure to fail: reliance on trial court scrutiny of the settlement...” John C. Coffee, Jr., Class Action Accountability: Reconciling Exit, Voice, and Loyalty in Representative Litigation, 100 COLUM. L. REV. 370, 438 (2000) (footnote omitted). In the class action context, an admonition for heightened judicial scrutiny is like dieting: a healthy and heartfelt aspiration that seldom produces results.
$250 million without any direct payment to the class, and named plaintiffs who had a close familial relationship to class counsel, thus casting serious doubt as to their objectivity and detachment.\textsuperscript{51} If Judge Newman was concerned that clear sailing agreements pose the risk of impermissible bargaining of merit relief for fees, it is hard to imagine a more damning set of facts that would warrant judicial intervention.

III. SETTLEMENTS WITH CLEAR SAILING AGREEMENTS ARE MOST LIKELY TOO SMALL

Part III develops a theoretical framework for understanding the settlement dilemma that clear sailing agreements are ultimately trying to resolve, albeit sometimes at the expense of the class. Subpart A discusses how such agreements can facilitate collusive settlements. Subpart B argues that collusive settlements that systematically reduce total defendant liability also undermine the important deterrence function of class action lawsuits. Finally, subpart C concludes that the heightened-scrutiny approach as it is currently applied cannot correct the problem of underdeterrence.

A. Clear Sailing Agreements and Collusive Settlements

Courts and commentators have long recognized the difficult agency problems that plague class action settlements.\textsuperscript{52} However,

\textsuperscript{51} See supra notes 36-38, 42 and accompanying text.

\textsuperscript{52} See, e.g., Ortiz v. Fibreboard Corp., 527 U.S. 815, 852 (1999) (acknowledging that the specter of "gigantic fees" may undermine arm's length bargaining); Brytus v. Sprang & Co., 203 F.3d 238, 249 (3d Cir. 2000) (Stapleton, J., dissenting) (observing that by eliminating the risk of nonpayment, settlements can pose a "significant conflict of interest between plaintiff class members and their counsel"); Third Circuit Report, supra note 9, at 266 ("Even if the plaintiff's attorney does not consciously or explicitly bargain for a higher fee at the expense of the beneficiaries, it is very likely that this situation has indirect or subliminal effects on the negotiations. And, in any event, there is an appearance of a conflict of interest."); Posner, supra note 6, at 627 (observing that "the lawyer for the class will be tempted to offer to settle with the defendant for a small judgment and a large legal fee, and such an offer will be attractive to the defendant, provided the sum of the two figures is less than the defendant's net expected loss from going to trial" and noting that court approval of a settlement may ultimately prove ineffectual because the collusive parties control information necessary to evaluate the fairness of a settlement); Alexander, supra note 26, at 536 (noting that class actions "are characterized by high agency costs: that is, a significant possibility that litigation decisions will be made in accordance with the lawyer's economic interests rather than those of the class"); John C. Coffee, Jr., Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions, 86 COLUM. L. REV. 669, 714 (1986) ("[P]laintiff's attorneys and the defendants can settle on a basis that is adverse to the interests of the plaintiffs. At its worst, the settlement process may amount to a covert exchange of a cheap settlement for a high award of attorney's fees." (footnote omitted)).
settlements that include clear sailing agreements often present especially difficult problems for the supervisory court because they frequently arise in cases where class relief is either nonpecuniary, and therefore hard to measure, or indeterminate at the time of the Rule 23(e) fairness hearings due to a common fund that is subject to a reversionary provision. In a typical common-fund class action, attorneys’ fees are usually based on the percentage of the fund approach, which uses the total relief available to the class as a benchmark for calculating reasonable fees. However, in cases involving nonpecuniary relief or a claims-made reverter provision, the lack of a clearly definable or liquid common fund severely limits the ability of class counsel to assess his expected payment, thus complicating the decision whether to settle the lawsuit. Yet a clear sailing agreement mitigates this problem by allowing the plaintiff’s attorney to present to the supervising court a package deal of merit relief and fees that is willingly endorsed by the defendant. In short, the primary function of the clear sailing agreement is to reduce the level of uncertainty regarding fees to a point where the plaintiff’s attorney can confidently enter into a settlement.

Although the named plaintiff technically retains the right to direct the litigation, numerous commentators have long accepted the reality that the plaintiff’s attorney is the real party in interest. When the

53. See supra notes 27-29 and accompanying text.
54. Swedish Hosp. Corp. v. Shalala, 1 F.3d 1261, 1268-71 (D.C. Cir. 1993) (requiring the use of the percentage of the fund method); Camden I Condo. Ass’n v. Dunkle, 946 F.2d 768, 774 (11th Cir. 1991) (requiring the use of percentage of the fund method); Rawlings v. Prudential-Bache Props., 9 F.3d 513, 515-16 (6th Cir. 1993) (discussing the “recent trend towards adoption of a percentage of the fund method”); Weinberger v. Great N. Nekoosa, 925 F.2d 518, 526 n.10 (1st Cir. 1991) (observing “the tendency exhibited by some courts, particularly in common-fund cases, to jettison the lodestar in favor of a ‘reasonable percent of the fund’ approach”); In re Am. Bank Note Holographics, Inc., 127 F. Supp. 2d 418, 431 (S.D.N.Y. 2001) (acknowledging “the trend of the district courts in this Circuit is to use the percentage of the fund approach to calculate attorneys’ fees”); In re Microstrategy, Inc., 172 F. Supp. 2d 778, 787 (E.D. Va. 2001) (noting that “trend in securities class actions and other common fund cases has been toward use of the percentage method”); see also Third Circuit Report, supra note 9, at 254-58 (recommending that courts use exclusively the percentage of the fund method, as opposed to the lodestar with risk multipliers, in cases involving a common fund). But see Longden v. Sunderman, 979 F.2d 1095, 1099 n.9 (5th Cir. 1992) (stating that the United States Court of Appeals for the Fifth Circuit has yet to adopt the percentage of fund approach in common-fund cases).
55. See, e.g., Swedish Hosp. Corp., 1 F.3d at 1272 (observing that a “majority of common-fund class action fee awards fall between twenty and thirty percent”); 3 FEDERAL JUDICIAL CENTER, MANUAL FOR COMPLEX LITIGATION § 24.121, at 189 (1995) (discussing the typical range between twenty-five to thirty percent and collecting examples).
56. Alexander, supra note 1, at 1520 (observing that “named plaintiffs are essentially figureheads, merely the ‘key to the courthouse door,’ . . . who play no real role in directing the
adversarial relationship is reconceptualized in this way, the important elements of a successful settlement can be stated with a fair degree of precision. The primary appeal of settlement for the defendant is the ability to ascertain his or her full liability with certainty. For this very reason, the United States Supreme Court overruled the ban on simultaneous negotiations in civil rights cases, where attorneys' fees are often a major component of total liability. In contrast, the class counsel is seeking to maximize his total fees against the risk of unsuccessful litigation and nonpayment. In a common-fund settlement, the percentage of the fund approach yields a fairly predictable range of fees. However, in hybrid common-fund cases in which the total relief is either indeterminate or difficult to measure, the total fee award is much more difficult to predict.

A clear sailing agreement partially offsets the risk of inadequate attorneys' fees by ensuring that a fee request under a specified maximum will not elicit any challenge from the defendant during the Rule 23(e) fairness hearing. However, as Judge Newman correctly observed, "[I]t is unlikely that a defendant will gratuitously accede to the plaintiffs' request for a 'clear sailing' clause without obtaining something in return. That something will normally be at the expense of the plaintiff class." Because the heightened-scrutiny approach

litigation" (quoting Saylor v. Lindsley, 456 F.2d 896, 900 (2d Cir. 1972)); see also Jonathan R. Macey & Geoffrey P. Miller, The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform, 58 U. Chi. L. Rev. 1, 3-6 (1991) (stating that "plaintiffs' class and derivative attorneys function essentially as entrepreneurs who bear a substantial amount of the litigation risk and exercise nearly plenary control over all important decisions in the lawsuit" and therefore urging that the nominal plaintiff requirement be eliminated). But cf Model Rules of Prof'l Conduct R. 1.7(b) (2002) (prohibiting a lawyer from considering his own interests, financial or otherwise, when representing his client).

57. See Third Circuit Report, supra note 9, at 267 (noting that the ability to fix total liability, including fees, is "the very certainty that makes settlement attractive to the defendant").

58. See Evans v. Jeff D., 475 U.S. 717, 734 (1986). The Court noted:

The adverse impact of removing attorney's fees and costs from bargaining might be tolerable if the uncertainty introduced into settlement negotiations were small. But it is not. The defendants' potential liability for fees in this kind of litigation can be as significant as, and sometimes even more significant than, their potential liability on the merits.

Id. For a discussion of the Prandini rule and its partial demise in Evans, see supra Part II.A.

59. This unpredictability can take several forms. For example, the court could find an expert evaluation of a nonpecuniary settlement unpersuasive. Alternatively, the court may eschew the common-fund approach altogether and perform a lodestar calculation without also applying risk multipliers.

60. Malchman v. Davis, 761 F.2d 893, 908 (2d Cir. 1985) (Newman, J., concurring); see also Weinberger v. Great N. Nekoosa Corp., 925 F.2d 518, 524 (1st Cir. 1991) (cautioning
often leads to a downward adjustment in attorneys’ fees, experienced counsel can partially compensate for this risk by moderately inflating the ceiling figure specified in the clear sailing clause. Yet even in the rare case where heightened scrutiny results in inadequate attorneys’ fees, approval of the underlying settlement permits the collusive defendant to retain the benefit of his bargain. As a result, class action settlements that are predicated on clear sailing agreements are likely to produce class relief that is systematically too low.

B. The Need to Impose Full Liability in Order to Deter Wrongful Conduct

One of the primary functions of the class action mechanism is the private enforcement of laws. Although class actions directly accomplish this goal by aggregating a multitude of relatively small claims into one lawsuit, thus making it economically attractive to a qualified attorney, private law enforcement is also enhanced when the specter of a large class action judgment deters potential defendants from engaging in wrongful conduct. As Judge Posner has observed, “the most important point from an economic standpoint is that the [class action defendant] be confronted with the costs of his violation—this achieves the allocative purpose of the suit—not that he pays them to his victims.” Therefore, when clear sailing agreements result in

that there is “a conflict inherent in cases like this one, where fees are paid by quondam adversary from its own funds—the danger being that the lawyers might urge a class settlement at a low figure or on a less-than-optimal basis in exchange for red-carpet treatment on fees”).

61. See supra note 48 and accompanying text.

62. See Alon Klement, Who Should Guard the Guardians? A New Approach for Monitoring Class Action Lawyers, 21 REV. LITIG. 25, 26 (2002) (discussing the private law enforcement function of class actions and noting that “class attorneys have made substantial contributions to deterrence and compensation, supplementing the public sector in pursuit of these goals”); Diane Wood Hutchinson, Class Actions: Joinder or Representational Device?, 1983 SUP. CT. REV. 459, 480 (arguing that Supreme Court decisions on class actions evidence two policies, “one favoring efficiency and economy of litigation, and one emphasizing the role of the class action as a supplement to public law enforcement efforts”).

63. See Amchem Prods. v. Windsor, 521 U.S. 591, 617 (1997) (discussing how class actions make small claims economical to litigate).

64. POSNER, supra note 6, at 678 (commenting that “our legal system has long accepted, if somewhat uneasily, the concept of the plaintiff’s attorney as an entrepreneur who performs the socially useful function of deterring undesirable conduct”); Kenneth W. Dam, Class Actions: Efficiency, Compensation, Deterrence, and Conflict of Interest, 4 J. LEGAL STUD. 47, 54-56 (1975) (discussing deterrence as a goal of the class action device); see also Miller & Singer, supra note 12, at 98 (explaining that “[j]f a company can anticipate becoming a defendant in a class action lawsuit when it violates the rights of large numbers of people, then it is less likely to engage in wrongful behavior”).

65. POSNER, supra note 6, at 626-27.
settlements that are systematically too low, the deterrence function of class actions can be seriously compromised. As a result, all of society is subject to higher levels of relatively minor but nonetheless wrongful conduct by defendants.

C. Problem of Clear Sailing Agreements Cannot Be Corrected by Judicial Oversight

There are at least two reasons why the problem of clear sailing agreements and artificially low class action settlements cannot be resolved by heightened judicial oversight. First, district courts lack both the resources and the incentive to vigorously pursue plaintiffs' interests in the face of a potentially collusive settlement. Judges who approve a settlement remove a potentially complex and time-consuming case from their docket, whereas a rejection of the settlement may very well result in further litigation. Moreover, approval of settlements is also favored by the ethos of the American legal system, which strongly encourages the voluntary settlement of legal claims, especially in the class action context. The favorable reception given to most settlement proposals is perhaps best summarized by a federal district court judge, who once quipped, "In deciding whether to approve this settlement proposal, the court starts from the familiar axiom that a bad settlement is almost always better than a good trial."

66. Professor Miller succinctly describes this dilemma:

[Judicial review of a settlement] is usually fairly ineffective at protecting plaintiff interests. The settlement is presented to the judge with the enthusiastic endorsement of the plaintiff's lawyer, the defendant's lawyer, and (in derivative suits) the lawyer for the corporation. Often the only ones opposing the settlement are private individuals whose arguments may be unsophisticated or frivolous. Moreover, the trial judge knows that if he or she approves the settlement there is little likelihood that the decision will be appealed, whereas if he or she rejects it there is certain to be an appeal. If the judge approves the settlement, the case will be removed from the docket, whereas if he or she rejects the settlement the case will continue to clog the docket and may even eventuate in a trial.

Geoffrey P. Miller, Some Agency Problems in Settlement, 16 J. LEGAL STUD. 189, 214 n.73 (1987); see also Macey & Miller, supra note 56, at 45-46 (discussing reluctance of courts to reject settlements).

67. See Alleghany Corp. v. Kirby, 333 F.2d 327, 347 (2d Cir. 1964) (Friendly, J., dissenting) (commenting that "[a]ll the dynamics conduce to judicial approval of such settlements" once the parties have come to an agreement); Edward Labaton, Class Action Settlements, in 2 PRACTISING LAW INSTITUTE, SEcurities Litigation 1993: CURRENT STRATEGIES AND DEVELOPMENTS 351, 353-54 (1993) (discussing the favorable judicial attitude toward class action settlements and collecting cases on this issue).

A second reason why the heightened-scrutiny approach is an inadequate response to clear sailing agreements is the strong possibility that the underlying settlement agreement is the product of tainted negotiations. Although a court may be confident that it can police unethical conduct through a reduction in attorneys’ fees, such an approach leaves intact a settlement that systematically favors defendants at the expense of the class. An optimal solution to the problem of clear sailing agreements would permit defendants to ascertain their total liability in a settlement agreement while also providing plaintiff’s counsel with a reliable mechanism for securing adequate fees. A proposed structural remedy to this incentive problem is discussed in Part IV.

IV. PROPOSED SOLUTION THAT ELIMINATES THE NEED FOR CLEAR SAILING AGREEMENTS

The solution proposed by this Article is straightforward. First, courts should adopt a per se ban on all class actions settlements that have utilized a clear sailing provision. Cases that formerly would have utilized a clear sailing agreement can be distinguished from typical common-fund cases by their reliance on nonpecuniary relief or a claims-made common fund with a reversionary provision. The hallmark of these cases is that the liability of the defendant is not fixed by a cash payment (or a series of cash payments). Because the process of calculating attorneys’ fees inevitably requires that the settlement be given a discrete dollar value, these cases will often create novel valuation problems. Unfortunately, both the defendant and the class counsel advance their own interests by supplying the court with estimates that are exaggerated or overly optimistic. 69

In the event the settling parties propose a settlement that cannot be readily reduced to a fixed dollar value, the supervising court should appoint a guardian ad litem to represent the class on the issue of attorneys’ fees. 70 Although the plaintiff’s counsel will need to negotiate

69. See Klement, supra note 62, at 42-43 (discussing the types of settlements that present difficult valuation problems and thus opportunities for settlements that “would increase the lawyer’s fee with no accompanying benefit to the class”).
70. This reform has been proposed by Professors Macey and Miller in the fee-setting context, see Macey & Miller, supra note 56, at 47-48, and by another commentator in the settlement context generally, see Sylvia R. Lazos, Note, Abuse in Plaintiff Class Action Settlements: The Need for a Guardian During Pretrial Settlement Negotiations, 84 Mich. L. Rev. 308, 325-32 (1985). In contrast, this proposal is limited to settlements involving nonpecuniary or claims-made reversionary funds. In these types of cases, courts are often faced with difficult valuation issues, which is a settlement form that is conducive to collusion,
a settlement that has sufficient liquidity to eventually pay reasonable attorneys' fees, this sum will be presumed to be part of the common benefit accruing to the class. After an adversarial proceeding to determine the merits of the fee petition, the plaintiff's attorney would receive compensation that is commensurate with the benefit conferred upon the class. In turn, the common fund would be modestly taxed to pay the fee of the guardian ad litem.

A. Rule 23(e): District Courts Should Not Approve Settlements with Clear Sailing Agreements

The first step in implementing this solution is for courts (preferably federal appellate courts) to abandon the heightened-scrutiny approach and adopt a per se rule against the use of clear sailing agreements in class action settlements. The primary virtue of this approach is that it addresses the serious risk that a clear sailing provision may be obtained only at the expense of the class. Although such an approach might, at first glance, appear to frustrate the policy objective of encouraging settlements, the importance of attorneys' fees within the class action bar ensures that the expectations of practicing attorneys will quickly adjust to a different set of ground rules. Assuming that a defendant can limit his liability to an amount lower than his expected cost at trial and the plaintiff's attorney can

and a lack of adversarial proceeding due to the high likelihood that such a settlement includes a clear sailing agreement. In this author's opinion, appointing a guardian as a matter of course would not be necessary insofar as the incentives of the plaintiff's attorney align with the class.


If an agreement is reached on the amount of a settlement fund and separately providing an amount of attorney's fees and expenses, both amounts should be disclosed to the class. Moreover, the sum of the two amounts ordinarily should be treated as a settlement fund for the benefit of the class, with the agreed-on fee amount constituting the upper limit of the fees that can be awarded to counsel.

Id.

72. See, e.g., In re Fleet/Norstar Secs. Litig., 935 F. Supp. 99, 110 (D.R.I. 1996) (relying on the guardian ad litem report to reduce attorneys' fees by more than $600,000 and using $25,000 of this savings to pay the guardian).

73. See Malchman v. Davis, 761 F.2d 893, 908 (2d Cir. 1985) (Newman, J., concurring) (observing that clear sailing agreements increase "the likelihood that plaintiffs' counsel . . . will bargain away something of value to the plaintiff class").

74. See supra notes 66-68 and accompanying text.

75. See POSNER, supra note 6, at 626-27 (discussing the calculus made by the defendant).
predict his fees with a fair degree of certainty, negotiated settlements will result.

The proposed ban would most likely have its greatest effect on settlements that present difficult valuation problems, such as coupons or reverter funds. This result follows from the fact that clear sailing agreements are necessary to reduce the uncertainty for plaintiffs’ attorneys on the issue of fees. Insofar as these types of agreements would have formerly served as a vehicle for collusive settlements, permitting a defendant to terminate the class action at a low price in exchange for excessive attorneys’ fees (and silence on this issue at the Rule 23(e) fairness hearing), we might expect litigants to return to a cash-based settlement. Based on the extensive criticism levied against nonpecuniary relief, this might, in fact, be a good result. On the other hand, there could very well be instances where nonpecuniary or reverter provisions offer class members the most satisfactory form of relief. For example, rather than a nominal sum of cash, class members may get more economic value out of coupons that offer steep discounts for a product that they need anyway (e.g., shampoo). Moreover, defendants may be willing to offer a significantly higher value in nonpecuniary relief in order for the opportunity to retain the class member as a customer.

Under the proposed ban, nonpecuniary or reverter-fund relief would still be possible. However, the rule would likely filter out collusive settlements because the plaintiff’s attorney would have less confidence that the exaggerated benefit to the class would survive the

76. See, e.g., Miller & Singer, supra note 12, at 107-12 (discussing criticisms of nonpecuniary relief, including serious valuation problems that permit lawyers to exaggerate the benefit conferred on the class and thus obtain a larger fee and commenting on the strong defendant preference for nonpecuniary relief, which can be leveraged against the plaintiffs’ attorney in a “reverse auction”, where defendants have several parallel cases occurring in different jurisdictions and award the settlement to the attorney who makes the lowest bid); Note, In-Kind Class Action Settlements, 109 HARV. L. REV. 810, 811 (1996) (arguing that valuation problems inherent in in-kind compensation “create[s] a troubling situation in which reviewing courts must act as blindfolded fiduciaries”).

77. See Miller & Singer, supra note 12, at 112-18 (discussing several examples, including coupons for shampoo, where consumer welfare is enhanced by nonpecuniary relief); see also Ohio Pub. Interest Campaign v. Fisher Foods, 546 F. Supp. 1, 5 (N.D. Ohio 1982) (approving a class action settlement involving coupons redeemable for groceries).

78. See, e.g., In re Mex. Money Transfer Litig., 164 F. Supp. 2d 1002, 1118-19 (N.D. Ill. 2000) (accepting expert testimony that “a well-designed coupon settlement can provide class members with more value than a cash settlement because the defendant is likely to be more generous in its coupon offer” and that “coupons may maintain or enhance existing customer relationships” (internal quotations omitted)); Gutterman v. Am. Airlines, No. 95 CH 982 (Ill. Cir. Ct. Cook County 1995) (offering discount of airline tickets or bonus frequent flier miles for class members in dispute over miscalculated frequent flier miles).
adversarial process against the guardian *ad litem*.

In short, the optimal rate and value of settlements could theoretically be achieved by replacing a clear sailing agreement with nontraditional class action relief that confers a real and substantial benefit on the class. The next section briefly outlines idiosyncratic features of nonpecuniary and reverter-fund relief that would need to be considered in structuring a socially efficient settlement.

**B. Defendant and Class Counsel Should Negotiate Only a Settlement for the Class**

After courts implement a per se ban against clear sailing agreements, a plaintiff attorney's best strategy for obtaining a high rate of return on a pending class action is to seek cost-effective ways to maximize the value of any future judgment or settlement. As discussed earlier, clear sailing agreements are largely superfluous to common-fund cases that result in a single lump-sum cash payment.

Therefore, in order to mimic these incentives in class actions involving nonpecuniary or indeterminate relief, it is important for the supervising court to clarify that all relief under the settlement presumptively belongs to the class until a second phase of the settlement process is convened to determine an award of attorneys' fees. Similar to a traditional common fund, the settlement should be conceptualized as a benefit conferred upon the class.

In order to safeguard appropriate levels of liability for defendants while also providing adequate financial incentives to plaintiffs' attorneys, it is necessary to consider how settlements will be structured

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79. *In re Fleet/Norstar Secs. Litig.*, 936 F. Supp. 99 (D.R.I. 1996), provides a good example of how the appointment of a guardian *ad litem* can alter the settlement calculus. Recognizing that "the very existence of a clear sailing agreement increases the likelihood that something of value will have been bargained away by counsel," the court appointed a guardian *ad litem* to prepare a report on the application for attorneys' fees. *Id.* at 104-05. The guardian's report documented a large number of errors, overcharges, and duplication of efforts, which in turn persuaded the court to reduce the total fee award. *Id.* at 110. Moreover, the court adopted the guardian's recommendation that class counsel should receive no compensation for settlement of a companion shareholder derivative lawsuit. *Id.* at 112-17. In addition to the possibility of a lower fee, fee proceedings expose a plaintiffs' attorney to possible reputation damage.

80. When competent and faithful agents negotiate a class action settlement, this Article asserts that their work product is both socially optimal and efficient. A settlement that is commensurate with the loss suffered by the plaintiff class, adjusted for the likelihood of prevailing in litigation, has the ameliorative effect of making wrongful conduct more expensive in the first instance; optimal deterrence, in turn, increases social wealth.

81. *See supra* note 26 and accompanying text.

82. For background on the equitable common-fund doctrine, see note 27.
in two contexts that normally give rise to clear sailing agreements: (1) settlements involving nonpecuniary relief and (2) common funds subject to a reversionary interest.

1. Settlements with Nonpecuniary Compensation

One problem posed by class action settlements that involve nonpecuniary relief is that they often lack liquidity, thus making it virtually impossible to apply the percentage of the fund method to determine and pay attorneys' fees. Therefore, this Article proposes that the attorney for the class negotiate a common fund that would be composed of both nonpecuniary relief (e.g., coupons for shampoo) and a cash component that would approximate the payout under the percentage of the fund approach. Under the current law, nonpecuniary relief often poses notoriously difficult valuation problems for courts, primarily because both the defendant and the plaintiff's attorneys have a strong incentive to exaggerate its value to the court.

However, the inclusion of the guardian ad litem provision could act as a check against an overly generous representation to the court during the class relief phase of the settlement. Assuming the plaintiff's attorney has vigorously pursued maximum relief for the class, the plaintiff's attorney will have ample evidence to prevail in an adversarial setting, thus justifying an award of attorneys' fees for the full monetary component included in the common fund. Moreover, a higher settlement is likely to be extracted from the defendant, which enhances the deterrent value (at least marginally) of the class action device.

83. For a discussion of the percentage of the common-fund approach, see notes 49-50.

84. The defendant wants to extinguish pending claims at a low actual cost, and the class attorney wants the perception of a large settlement in order to justify a high fee award. See Miller & Singer, supra note 12, at 112; see also Posner, supra note 6, at 627 (noting generally the problem of reviewing the adequacy of a class action settlement because "the lawyers largely control his access to the information—about the merits of the claim, . . . the likely damages if the case goes to trial, etc.—that is vital to determining the reasonableness of the settlement."). It should be noted, however, that a court sometimes uncritically accepts the litigants' valuation, glossing over the potential that a cash equivalent would have a significantly lower value. See, e.g., Shaw v. Toshiba Am. Info. Sys., 91 F. Supp. 2d 942, 975-76 (E.D. Tex. 2000) (accepting, uncritically, the face value of coupons for new Toshiba products as part of a class action settlement allegedly worth $2.1 billion).
2. Settlements Where Funds Revert to the Defendant

Serious valuation problems are also present in a claims-made common fund where residual funds revert back to the defendant. In these cases, a court reviewing a proposed settlement faces the dilemma of using the available fund as the benchmark for attorneys’ fees when the total funds actually claimed, perhaps due to the administrative costs confronted by class members who attempt to access their relatively minor relief, may be only a fraction of this larger amount. For example, in Waters v. International Precious Metals, the defendant and the plaintiff’s attorney successfully negotiated a $40 million settlement in a class action involving fraud in the sale of commodity futures. Class counsel then petitioned the court for a fee award of thirty-three and one third percent, which the defendant did not oppose pursuant to a clear sailing agreement. However, shortly after the court awarded the full $13.33 million in fees, the defendant appealed the propriety of the award because the class had only claimed $6.5 million of the common fund. Remarkably, the United States Court of Appeals for the Eleventh Circuit affirmed this judgment under the abuse of discretion standard.

In a short memorandum opinion in which the Supreme Court denied certiorari, Justice O’Connor expressed dismay at the disproportionately large attorneys’ fees but declined to support a full review by the Court. Nevertheless, because the defendant had waived his right to contest attorneys’ fees under a clear sailing agreement, Justice O’Connor observed that “this particular case does not present a suitable opportunity for its resolution.” Under the analysis offered in this Article, it is important to recognize that it would be relatively rare for a plaintiff’s attorney to agree to a reverter-fund settlement without also having the security of a clear sailing agreement to reduce the uncertainty in his fee award. Ironically, the Court’s denial of

85. See Klement, supra note 62, at 43 (observing that “imposition of difficult-to-satisfy conditions on class action members who wish to collect their share” may inflate the perceived value of the settlement).
86. 190 F.3d 1291, 1292 (11th Cir. 1999).
87. Id. at 1292-93.
88. Id. at 1293-95 & n.6. The balance of approximately $21 million reverted to the defendant, making more than half of the $40 million settlement an illusory benefit to the class.
89. Id. at 1300.
91. Id. at 1224.
92. See supra Part III.A.
certiorari suggests that freedom of contract between the plaintiff’s attorney and the defendant may ultimately pose a barrier to courts that attempt to remedy agency problems inherent in class action settlements.

One way that courts have mitigated the potential for collusive settlements in reverter-fund cases is to stage the payment of attorneys’ fees in accordance with payouts made under the claims process. Although the law is currently unclear on whether the Supreme Court’s holding in *Boeing Co. v. Van Gemert* requires that attorneys’ fees be calculated according to the total fund available for relief rather than the actual payout, the ability to award attorneys’ fees according to actual (rather than projected) class relief gives the courts a tremendous tool for eliciting accurate information from the plaintiff’s attorney during the merit relief phase of the settlement process.

It is important to emphasize that the issue of attorneys’ fees would not be a necessary component of the initial settlement between the defendant and plaintiff’s attorney. Rather, the parties could make projections on the number of claims that will be made during the recovery period. Then, during the fee-award phase of the settlement process, the court could use an adversarial process with the guardian *ad litem* to determine total attorneys’ fees under the common-fund doctrine; a subsidiary but important issue would be the extent to which attorneys’ fees will be staged according to claims experience. Assuming the plaintiffs’ attorney vigorously negotiated a settlement against the defendant and minimized administrative obstacles that would obstruct the members of the class from accessing their relief, the plaintiffs’ attorney will have a cogent explanation for the residual uncertainty in the total settlement value and a strong case for the immediate payment of most or all of its fees.

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93. See, e.g., Duhaime v. John Hancock Mut. Life Ins., 989 F. Supp. 375, 378-80 (D. Mass. 1997) (staging a payout of approximately one-half of attorneys’ fees in order to ensure that the class counsel monitors the claims process and effectuates maximum class relief); see also Strong v. BellSouth Telecomm., 137 F.3d 844, 852-53 (5th Cir. 1998) (holding that the district court did not abuse its discretion basing attorneys’ fees on the actual payout rather than the size of fund available for relief).


95. See, e.g., Petruzzi’s, Inc. v. Darling-Delaware Co., 983 F. Supp. 595, 604-05 (M.D. Pa. 1996) (stating that under *Boeing*, a common fund held in escrow for the class requires that courts ignore the actual payout when determining attorneys’ fees, while a contractual duty to make payouts directly to plaintiffs during the claims process permits a staged award of attorneys’ fees commensurate with actual payout); see also Int’l Precious Metals, 530 U.S. at 1224 (noting the split between the Fifth and Ninth Circuits on whether attorneys’ fees in reversionary funds can be calibrated to the actual payout).
C. Appointing a Guardian Ad Litem to Represent the Class When Determining Attorneys' Fees

The lynchpin of the proposal presented in this Article is the appointment, as a matter of course, of a guardian *ad litem* in all class action settlements that include nonpecuniary relief or a common fund subject to a reversionary interest. A district court’s supervisory power under Rule 23 is a sufficient basis to ground such a rule. Moreover, its adoption can be clearly signaled to the local bar through its acceptance as a local court rule.

Although the guardian would not be appointed until the settlement on the merits relief has been provisionally approved, the specter of a court-appointed advocate challenging the attorneys’ fee petition will most likely have a significant impact on bargaining dynamics and trade-offs proposed by the defendant and class counsel. Collusion on the part of the plaintiffs’ attorney could potentially jeopardize his or her final payment. As one court described this option, “The rationale for appointing a guardian ad litem in the fee award proceeding following the settlement of a case . . . is that the guardian fulfills the advocate’s role abandoned by the defendant [after extinguishing all claims through a common-fund settlement].”

Because this proposal restores the adversarial process to the determination of attorneys’ fees, the trade-off between fees and merit relief will be much less likely to occur.

V. CONCLUSION

This Article proposes a solution to the long-standing concern by courts that clear sailing agreements may ultimately serve as a vehicle for collusive settlements. By reviewing the existing case law and clarifying that clear sailing agreements are most prevalent in cases involving either nonpecuniary relief or a common fund with a reversionary interest, this Article sets forth a useful framework for

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96. Gottlieb v. Barry, 43 F.3d 474, 490 (10th Cir. 1994) (acknowledging arguments for a guardian *ad litem*, but denying such an appointment as a matter of right).

97. Compare *In re Fleet/Norstar Secs. Litig.*, 935 F. Supp. 99, 104-05 (D.R.I. 1996) (appointing a guardian *ad litem* because the “absence of adversity makes judicial oversight of both of these fee agreements highly desirable, especially since the very existence of a clear sailing agreement increases the likelihood that something of value has been bargained away by counsel”), with *Malchman v. Davis*, 761 F.2d 893, 907-08 (2d Cir. 1985) (Newman, J., concurring) (criticizing the use of clear sailing agreements because they deny the scrutiny of the adversarial process to the setting of attorneys’ fees and make a trade-off between merit relief and fees significantly more likely to occur but nonetheless voting to approve a settlement arising in that very context).
understanding the difficult incentive problems faced by both litigants and courts. The solution of a two-phase adversarial process, the first between the plaintiffs' attorney and the defendant and the second between the plaintiffs' attorney and a guardian ad litem, offers a reasonable opportunity for courts to preempt collusive settlements and ultimately preserve the deterrence function of the class action device.